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DE RUEHBS #0635/01 1251038
ZNR UUUUU ZZH
P 051038Z MAY 09
FM USEU BRUSSELS
TO RUEHC/SECSTATE WASHDC PRIORITY
RHEHNSC/NSC WASHDC PRIORITY
INFO RUCNMEM/EU MEMBER STATES COLLECTIVE
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UNCLAS SECTION 01 OF 04 BRUSSELS 000635

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SUBJECT: EUROPE FINANCIAL AND ECONOMIC REPORT: May 4th,
2009
FINANCIAL SERVICES: UPCOMING ISSUES /EVENTS

ECOFIN to discuss EC's Spring economic forecasts, give final
approval to CRA and Solvency II legislation:

¶1. (SBU) On May 5, the ECOFIN Council will meet to discuss the
Commission's Spring economic forecast and to formally adopt the
Regulation on Credit Rating Agencies and the Solvency II Directive,
both recently approved by the European Parliament. Ministers will
exchange views on how to cross-border information sharing on tax,
and will begin examining the draft budget for 2010. The meeting
will be preceded by a EUROGROUP meeting on May

FINANCIAL SERVICES: RECENT EVENTS:

Vote on Capital Requirement Directives (CRD) on May 6:

¶2. (SBU) Following a delay due to an attempt by several MEPs to
increase the 5% retention requirement on securitized products, on
April 29 the Member States adopted a proposal that leaves the
threshold unchanged, but requires the Commission to assess the
effectiveness of the measure and report back to the European
Parliament (EP) by the end of 2009. The EP is expected to adopt the
Directive on May 6, since a negative vote would force the
negotiations to restart and make the adoption of the measure
unlikely before the end of 2009.

European Parliament requires credit rating agencies to be registered
and supervised in the EU:

¶3. (SBU) On April 23, the European Parliament adopted a Regulation
that will require all credit rating agencies (CRAs) whose ratings
are used for regulatory purposes in the EU to be registered and
supervised by competent national authorities. The vote seals an
agreement previously reached by Member State representatives. The
Regulation sets rules for overseeing rating companies, mandates that
analysts rotate positions, and introduces internal governance
arrangements to limit conflicts of interest. The regulation also
allows European subsidiaries of credit rating agencies located
outside of the EU to endorse the ratings produced by their parent
companies, if a number of criteria are met. Ratings from smaller,
non-systemically important CRAs from jurisdictions deemed equivalent
by the EU can be used without being endorsed. The Regulation will
enter into force as soon as it is published in the Official Journal,
with a 12-month delay for the endorsement provision.

European Parliament approves Solvency II:

¶4. (SBU) On April 22, the European Parliament adopted the Solvency
II Directive, which replaces the current rule-based approach to

determine solvency and capital requirements for EU insurance and reinsurance companies with a more sophisticated, risk-based regime. The new legislation will introduce colleges of supervisors to oversee cross-border insurance companies and will harmonize reporting requirements. The Commission will set up a mechanism to determine third-country equivalence and EC officials have indicated that the U.S. will likely not be found equivalent. Insurers from non-equivalent jurisdictions will likely have to establish a holding company in Europe and choose a home MS as supervisor.

ECONOMICS / FINANCE: UPCOMING ISSUES / EVENTS

Commission proposes to register and regulate fund managers:

15. (SBU) On April 29, the European Commission presented its proposal to regulate Alternative Investment Fund Managers (AIFMs). The proposed Directive will require all AIFMs managing portfolios of more than 100 million to be authorized and be subject to harmonized regulatory standards on an ongoing basis. Criteria for authorization:

- Be established in the EU;
- Manage non-UCITS assets in excess of 100 million (or 500 million if unleveraged);
- Hold and retain a minimum level of capital.

AIFMs managing leveraged funds will be subject to more stringent requirements, which the Commission will determine separately from this Directive. Any registered AIFM will be authorized to market funds to professional investors throughout the EU and to manage funds domiciled in other Member States without being subject to additional requirements. Funds domiciled in third countries will

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have to be authorized separately in each MS in which they seek investors. Funds domiciled in third countries may also be managed by a registered AIFM after a three-year transitional period if the third country jurisdiction's regulatory and supervisory standards, including exchange of information on tax matters, is deemed to be equivalent to the EU's.

Commission to seek authority to end banking secrecy in the EU:

16. (SBU) On April 28, the Commission outlined its intention to increase transparency and exchange of tax information in the banking sector, both within the EU and with third countries. EU Taxation Commissioner Lazlo Kovacs is seeking authority to negotiate with Switzerland, Liechtenstein, San Marino, Monaco and Andorra a provision to exchange information on request. If these five countries agree to share information with the EU, then the temporary opt-out which has allowed Luxembourg, Austria and Belgium to apply a special withholding tax on the savings accounts of non-residents instead of sharing data will cease. At the May 5 ECOFIN, Member State Finance Ministers are expected to hold an exchange of views on the issue.

Germany to develop a "bad bank" approach to impaired assets:

17. (SBU) The German government is working on a "bad bank" approach to impaired assets, in which the government would create special purpose vehicles (SPVs) to purchase impaired assets from banks at book value in exchange for a government-guaranteed bond of the same amount. A third party will then assess the fair value of the asset and the bank will be required to take a provision equal to the difference between the book value at which the asset was sold and the fair value. The scheme will likely be voluntary. Deutsche Bank has already announced it will not take part and the main participants will likely be: HypoRE, Commerzbank/Dresden, and the

Landesbanken. Some questions remain open.

- What is the time period over which the bank is required to take the provision for the difference between book and fair value?
- If the fair value of the asset declines after the initial sale, what will be the burden sharing between the government and the bank?

The government is expected to announce a program by the end of the week

Commission asks Member States to tighten rules on remuneration in the financial sector:

18. (SBU) On April 29, the European Commission published measures to ensure that financial institutions put in place remuneration policies designed to prevent excessive risk-taking. Supervisors in all Member States are invited to ensure that these principles, which target directors and risk-taking staff, are applied to the largest possible extent, although their application is voluntary. However, Commissioner McCreevy has announced that he will propose an amendment to the Capital Requirements Directive making the bulk of these proposals a binding requirement.

Commission outlines its vision on investor protection for packaged retail investment products:

19. (SBU) On April 29, the European Commission published a set of principles that will guide its work in developing - by the end of 2009- a comprehensive legislative approach to product disclosures and selling practices for retail investment products such as investment funds, insurance-based investments and other types of structured products. The Commission aims to restore investor confidence in these products by improving product information requirements. Rules on product sales will also be made more coherent.

Commission looks at whether short selling should be regulated:

110. (SBU) The European Commission launched a public consultation on the review of the Market Abuse Directive (2003/6/EC) on insider trading and market manipulation. The consultation seeks stakeholder input into whether EU legislation should be simplified and whether the EU should introduce rules requiring short sellers to register

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their holdings with the authorities. The Commission fears that differing rules on short-selling (recently temporarily banned in some countries) may lead to extra costs and be detrimental to financial market integration. On insider trading, the Commission may simplify administrative procedures and raise the current 5,000 threshold above which suspect deals must be reported. The results of the review are expected in the fall.

Commission wants harmonized rules for "intermediated" securities:

111. (SBU) The European Commission opened a public consultation on how securities are held and exchanged, and how to improve legal certainty. The Commission seeks to harmonize the rules on holding securities and transferring them across EU member states. There are currently no EU-level rules on book-entry securities, no guidelines on how they should be transferred from the seller to the buyer, especially for cross-border transactions, and a lack of certainty regarding registration of ownership of securities. This consultation is a step towards the release of legislative proposals on "intermediated" securities - those held in bank accounts, by brokers or in central securities depositories - which is expected before the end of 2009.

Fortis shareholders approve sale to BNP Paribas:

¶12. (SBU) On April 30, Fortis shareholders approved the sale of 75% of the group's banking business (currently owned by the Belgian government) and of 25% of the group's insurance business to BNP Paribas, making it the Eurozone's largest deposit holder. A lawyer for the shareholders who opposed the deal promised more legal actions.

ECONOMICS / FINANCE: RECENT EVENTS:

ECB expected to lower rates and may announce QE measures, BoE likely on hold:

¶13. (SBU) On May 7, the ECB Governing council is expected to cut its main interest rate by 25 basis points. There have been diverging comments from ECB Governing Council members on whether or not the ECB will adopt quantitative easing tools. The Bank of England will also announce rate decisions next Thursday, and economists believe that the rate and the GBP 75bn asset purchase program will remain unchanged.

ECONOMICS / FINANCE: UPCOMING ISSUES / EVENTS

EC's Spring economic forecasts predict "tough" 2009:

¶14. (SBU) May 4, the European Commission released its latest economic forecasts for the EU and the Euro area. GDP in both areas is projected to fall by 4% this year and to broadly stabilize in ¶2010. The main factors behind the decline are the worsening of the global financial crisis, a sharp contraction in world trade and the ongoing housing market correction in some economies. However, the Commission believes that the fiscal and monetary stimulus measures will have an effect and growth will regain momentum in the course of ¶2010. An increase of unemployment is also forecasted, with the jobless rate to reach 11% in 2010.

EU government deficits for 2008 rose significantly compared to 2007:

¶15. (SBU) Government deficits and debt in both the euro area and the EU27 increased from 2007 to 2008. In the euro area, combined government deficits increased from 0.6% of GDP in 2007 to 1.9% in 2008, and in the EU27 from 0.8% to 2.3%. Government debt also

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increased, but less dramatically, from 66.0% of GDP at the end of 2007 to 69.3% at the end of 2008 in the euro area, and from 58.7% to 61.5% in the EU27. In 2008, the largest government deficits were recorded by Ireland (-7.1%), the United Kingdom (-5.5%), Romania (-5.4%) and Greece (-5.0%), while Italy (105.8%), Greece (97.6%), and Belgium (89.6%) posted the highest debt ratios.

EU jobless rate rises as inflation stabilizes, business and economic confidence pick up:

¶16. (SBU) Europe's unemployment rate rose to 8.9% in March, the highest since November 2005, while Euro area inflation for April is estimated stable at 0.6%. The Business Climate Indicator (BCI) for the euro area increased in April for the first time since May 2008. Despite remaining at very low levels (-3.33), it showed improvement

over March (- 3.49). The Economic Sentiment Indicator (ESI) for the EU and the euro area also increased in April - for the first time since May 2007 - by 3.5 points in the EU, and by 2.5 points in the euro area, to 63.9 and 67.2 respectively.

MURRAY